

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

OF

**Red Shield Insurance Company
Seattle, Washington**

**NAIC CODE 41580
DECEMBER 31, 2003**

**Participating States:
Washington**

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Red Shield Insurance Company of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2003.



PATRICK H. MCNAUGHTON

Chief Examiner

5-12-05

Date

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SALUTATION

Seattle, Washington
May 12, 2005

The Honorable Alfred E. Gross
Chair, NAIC Financial Condition (E) Committee
Commissioner
Virginia Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, VA 23219

The Honorable Linda Hall
Director, Alaska Division of Insurance
NAIC Secretary, Western Zone
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

The Honorable Mike Kreidler, Commissioner
Washington Office of Insurance Commissioner (OIC)
Insurance 5000 Building
5000 Capital Blvd.
Tumwater, WA 98504-0255

Dear Commissioners and Director:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Red Shield Insurance Company

of

Seattle, Washington

hereinafter referred to as "RSIC" or the "Company," at the location of its home office, 7245 West Marginal Way S.W., Seattle, Washington 98106-3997. This report is respectfully submitted showing the condition of the Company as of December 31, 2003.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1999 through December 31, 2003 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2003 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1) NAIC Annual Statement Errors and Misclassifications

The examination team discovered several instances in which the Company's filing of the 2003 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions. While the Company needs to correct these practices, none of the following were material to the financial statements and no examination adjustments were made.

The Company is instructed to comply with RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the NAIC Accounting Practices and Procedures Manual, and the NAIC Annual Statement Instructions. The following exceptions were noted in our examination:

a. Vanguard Mutual Investments

The Company's investments in Vanguard Mutual Funds were incorrectly classified as short-term investments. This classification was not in compliance with the AP&P which required the investments to be classified as stocks.

b. Tax Overpayment Classification

The Company incorrectly offset tax overpayments and refunds against its other expense liabilities. This offset was not in compliance with the NAIC Annual Statement Instructions which requires tax refunds to be included in Aggregate write-ins for other than invested assets line.

c. Advance Premiums

The Company did not report any advance premiums on Line 10 of Page 3 (Liabilities, Surplus, and Other Funds) of the 2003 NAIC Annual Statement, when, in fact, premiums had been received in advance of the effective date on several policies. The advance premiums were netted against premiums receivable on Line 12.1 (Uncollected premiums and agents' balances in the course of collection).

d. Remittances and Items Not Allocated

The Company incorrectly reported remittances and items not allocated in the amount of \$111,105 as a reduction (credit) to premiums receivable on Line 12.1 (Uncollected premiums and agents' balances in the course of collection) of the Asset Page (Page 2.) Remittances and items not allocated should have been reported on Line 15 (Remittances and items not allocated) of the Liabilities, Surplus, and Other Funds Page (Page 3).

e. Commissions Payable

The Company did not record a liability for commissions payable to offset premiums receivable, gross of commissions. This was not in compliance with SSAP's 71 and 6 which require balance sheet amounts to be net of applicable commissions. This error caused an understatement of the Company's liabilities by \$22,947 as of December 31, 2003.

f. Assumed Reinsurance on Paid Losses – Rainier Insurance Company (RIC)

The Company offset its liabilities for loss payable on assumed reinsurance from RIC against the receivable for premiums assumed. This offset was not in compliance with SSAP 62, paragraph 40 which requires that the liabilities for losses on assumed reinsurance be recorded as a separate line item on the liability page of the balance sheet. In addition, this error caused several schedules and exhibit balances to be incorrect.

g. Guaranty Fund Assessment

The Company did not accurately report its receivable for guaranty fund assessments that are subject to future premium tax offset. The receivable balance was underestimated by \$9,617 as of December 31, 2003. This amount is available for future offset of Washington State premium taxes.

h. Undisclosed Transactions with Related Parties

The Company had transactions with affiliates which were not properly disclosed in its NAIC Annual Statements as required and defined by SSAP 25. Related parties are entities that have common interests as a result of ownership, control, affiliation, or by contract. Jones Stevedoring Company, Rainier Insurance Company, Red Shield Service Company, and Red Shield Financing Company all qualified as related party affiliates of Red Shield Insurance Company based on this criteria. As such, the nature and amount of the transactions between the parties should have been properly disclosed on Schedule Y of the NAIC Annual Statement, the Notes to the Financial Statements, and Schedule F, affiliated reinsurers.

i. Misclassification of EDP Equipment, Software, Furniture, and Fixtures

During our review of Aggregate write-ins for other than invested assets, we noted that the Company classified the following items incorrectly:

EDP equipment and software	\$21,592
Leasehold Improvements	28,920
Furniture & Fixtures	35,610

According to the NAIC Annual Statement Instructions, EDP equipment and software should have been recorded in Line 17 EDP equipment. Leasehold Improvements and Furniture and Fixtures should have been recorded in Line 18 Furniture & Equipment.

All of the above amounts were not admitted by the company and the misclassifications had no impact on surplus.

2) Incorrect Transaction Date

During our examination of investment schedule details for the period ended December 31, 2003, it was noted that the Company incorrectly used the settlement date as the date of the transaction rather than the trade date. This was not in compliance with SSAP 26, paragraph 4, for bonds, SSAP 30, paragraph 5, for common stocks, and SSAP 32, paragraph 10, for preferred stocks.

The Company is instructed to comply with RCW 48.05.073, which requires every insurer to "... file its financial statements in accordance with the accounting practices and procedures manual..."; RCW 48.05.280, which stipulates that, "Every insurer shall keep full and adequate accounts and records of its assets, obligations, transactions and affairs."; WAC 284-07-050(2) which states that each company should prepare "an annual statement as promulgated by the NAIC ...insurers shall adhere to the appropriate NAIC Annual Statement Instructions and Accounting Practices and Procedures Manuals promulgated by the NAIC."

3) Investment Exceeded Limitations

The Company recorded in Schedule D of the 2003 NAIC Annual Statement the following investments in Vanguard Mutual Funds:

<u>CUSIP</u>	<u>Description</u>	<u>Amount</u>
922906-20-1	Prime Money Market Fund	\$ 732,399
922906-20-1	Inter-Term Corporate Adm	<u>1,250,000</u>
	Total	<u>\$1,982,399</u>

The total investments in Vanguard Mutual Funds of \$1,982,399 represented more than 5.15% of the Company's total assets of \$38,444,060. This amount exceeded the maximum amount that was allowed by RCW 48.13.030(1) by \$444,637 and the excess has been non-admitted in the examination report. (See Notes to the Financial Statements No.1)

The Company is instructed to comply with RCW 48.13.030(1) by limiting its investment in any single entity to four percent of its total assets.

4) Custodial Agreements

The Company's response to General Interrogatory No. 23 in its NAIC Annual Statement stated that the Company had custodial agreements with Wells Fargo Bank and Bank of America and that the agreements complied with the FCEH. However, the results of the examination disclosed that the Company did not have custodial agreements with Wells Fargo Bank and Bank of America. In addition, Vanguard Mutual Funds was acting as a custodian which was not in compliance with RCW 48.13.450.

The Company is instructed to comply with RCW 48.05.073, which requires every insurer to "... file its financial statements in accordance with the accounting practices and procedures manual..."; RCW 48.05.280, which stipulates that, "Every insurer shall keep full and adequate accounts and records of its assets, obligations, transactions and affairs."; WAC 284-07-050(2) which states that each company should prepare "an annual statement as promulgated by the NAIC ...insurers shall adhere to the appropriate NAIC Annual Statement Instructions and Accounting Practices and Procedures Manuals promulgated by the NAIC." The Company is

instructed to establish custodial agreements with Wells Fargo Bank and Bank of America, and transfer Vanguard Mutual Funds to an approved custodian as defined pursuant to RCW 48.13.450.

5) Reinsurance Intermediary Contract

During our review of reinsurance transactions, we noted that the Company employed Winthrop Insurance Plans, licensed in California in compliance with RCW 48.94.010(1)(b), as a broker of record (Reinsurance intermediary-broker) for its reinsurance contract with St. Paul Travelers Insurance Companies. However, the Company did not have a written authorization in place to specify each party's responsibilities, as required by RCW 48.94.015. RCW 48.94.015 requires that transactions between an insurer and a reinsurance intermediary-broker may only be entered into under a written authorization which stipulates each party's responsibilities.

The Company is instructed to execute an agreement with its reinsurance intermediary-broker which will comply with Chapter 48.94 RCW.

6) Income Tax Sharing Agreement

The Company declared in the Notes to Financial Statements that it filed a consolidated income tax statement with some of its affiliates based on a written agreement approved by the Board of Directors. However, the written agreement was only a Board of Directors' resolution to continue to file consolidated tax returns with some of its affiliates. The document does not qualify as a written income tax allocation agreement.

The Company is instructed to formalize the Income Tax Sharing Agreement to specifically outline the terms of the agreement. This formal agreement should be filed with the OIC in accordance with RCW 48.31B.025(2)(c)(viii). (The Company subsequently formalized and filed the agreement with the OIC in 2004.)

7) Non-Compliance with the Company's Bylaws

Our review of the Company's Bylaws revealed the following non-compliance issues:

a. Annual Meeting of the Shareholders

The Company did not hold an annual meeting of the shareholders as required by its Bylaws.

b. Board of Directors' Election

The Shareholders of the Company have not held any annual meetings as required by its Bylaws and RCW 48.07.040. The Company's Bylaws give the shareholders the power to elect the Board of Directors.

The Company is instructed to comply with RCW 48.07.040 which requires the Company to hold its annual meetings according to its Bylaws.

COMMENTS AND RECOMMENDATIONS

No comments or recommendations were made based on the result of the examination.

COMPANY PROFILE

History

The Company was incorporated on February 9, 1979, as a stock multiple line property and casualty insurer in the state of Washington. Additionally, the Company holds a certificate from the United States Department of Labor under the Longshore and Harbor Worker's Compensation Act. The Company specializes in underwriting general liability, residual dwelling, inland and ocean marine, as well as U.S. Longshore and Harbor (USL&H) Worker's Compensation and Liability for stevedoring operations.

Territory and Plan of Operation

The original certificate of authority was issued by the OIC on February 28, 1979, to transact the business of disability, property, marine and transportation, vehicle, general casualty and surety. The Company was licensed to operate in the following states as of December 31, 2003:

Arizona	California	Colorado
Idaho	Montana	Oregon
Utah	Washington	

Policies are written on a non-assessable basis using the Insurance Services Office forms, and workers' compensation is generally written with high deductibles. The USL&H and related liability business is produced on a direct basis and the remaining lines of business are produced by 354 independent agents. Currently, 83% of its total premium volume is derived through its independent agency network. The Company writes the majority of its business in the states of Washington and Oregon.

USL&H is underwritten in the Seattle, Washington office and written only on the Jones' Stevedoring group of companies. Liability coverage is also offered to these companies. The Portland, Oregon office underwrites policies other than USL&H and is the marketing office for business other than the stevedoring companies. The Company appoints agents and brokers directly for the sale of its products. Commissions are paid directly to agents and brokers.

Growth of Company

The following schedules reflect the growth of the Company by year based on the NAIC Annual Statement filings beginning in 1999:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2003	\$ 38,444,060	\$ 17,056,482	\$ 21,387,578
2002	37,400,746	17,085,284	20,315,462
2001	37,986,426	14,283,244	23,703,182
2000	35,380,083	15,090,112	20,289,971
1999	\$ 32,038,995	\$ 12,976,215	\$ 19,062,780

<u>Year</u>	<u>Net Premium Written</u>	<u>Net Underwriting</u>	<u>Net Investment Gains (Losses)</u>	<u>Net Income</u>
2003	\$ 9,183,031	\$ 173,141	\$ 1,100,411	\$ 820,845
2002	10,162,475	43,733	1,349,691	794,337
2001	7,197,625	373,006	1,594,030	1,270,391
2000	6,299,549	351,514	1,565,408	1,251,538
1999	\$ 5,548,902	\$ 290,660	\$ 1,452,012	\$ 1,262,265

AFFILIATED COMPANIES

The Company is 100% owned by its parent, Maritime Service Company. Maritime Service Company, in turn, is 100% owned by Rothschild International Corporation. Rothschild International Corporation is owned by Mr. Clayton R. Jones and his family. In addition, the Company is instructed to report Rainier Insurance Company, Jones Stevedoring Company, Red Shield Service Company, and Red Shield Financing Company as affiliated companies. (See Instruction No. 1h)

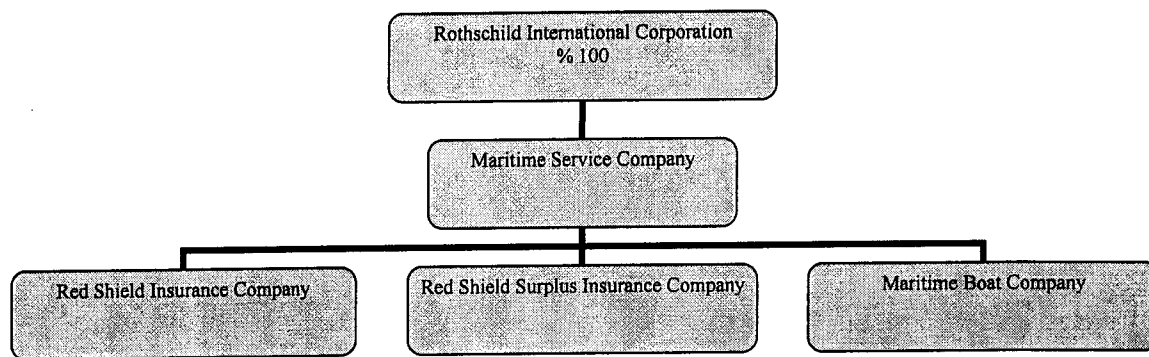
Rothschild International Corporation is owned by Mr. Clayton R. Jones and his family. Rothschild International Corporation is the upstream holding company which owns 100% of the stock of the Maritime Service Company. The ultimate controlling person, by virtue of majority ownership of the common stock, is Mr. Clayton R. Jones, Executive/Investor, who holds the office of president in all of the subsidiary companies.

Maritime Service Company (MSC) owns 100% of the stock of Red Shield Insurance Company, Red Shield Surplus Insurance Company, and Maritime Boat Company. MSC has and may loan unsecured amounts to its subsidiaries for short periods. There were no secured loans or exchanges of securities between subsidiaries as of December 31, 2003.

Red Shield Financing Company, an affiliated premium financing company, has contracted with the Company to provide an accounts receivable service to collect and finance premiums on behalf of the Company.

Red Shield Service Company, an affiliate, contracts with the Company for some management services; primarily, claims management and statistics.

The following organization chart is taken from the filed 2003 NAIC Annual Statement:



MANAGEMENT AND CONTROL

Ownership

The original authorized capital of the Company was 10,000 shares of common capital stock with a par value of \$100 per share. The Company issued one stock certificate for 6,500 shares of common capital stock to Maritime Service Company in consideration for \$1,300,000 which was obtained through a loan from Rothschild International Corporation. The consideration was split equally between paid-in capital stock and paid-in surplus.

A written consent resolution of the Board of Directors on December 19, 1983, amended the Articles of Incorporation which increased the authorized capital stock to 25,000 common shares at \$100 par value per share. The Company then issued a second stock certificate for 6,500 additional shares of common capital stock to Maritime Service Company and, through the same written consent resolution of the Board of Directors, transferred \$650,000 of contributed surplus to paid-in capital which increased the overall paid-in capital to \$1,300,000 and reduced the contributed surplus to zero. The Company increased the common share par value from \$100 to \$125 in 1999.

All issued and outstanding shares of stock of the Company are wholly owned by Maritime Service Company, a managing service company, which is wholly owned by Rothschild International Corporation, a corporation with Mr. Clayton R. Jones as majority owner..

Board of Directors

Article IV, Section 1 of the Bylaws states that a Board of Directors (BOD) shall manage the business affairs of the Company. The BOD is comprised of five (5) members. Election to fill vacancies existing or occurring in the BOD shall be held at the annual meeting of the stockholders, and directors so elected shall hold office until their respective successors shall have been elected and qualified. (See Instruction No. 7)

Following were directors, officers and committee members as of December 31, 2003:

<u>Directors</u>	<u>Principal Business Affiliation</u>	<u>Residence</u>
Clayton R. Jones	President and Director: Rothschild International Corporation Maritime Service Company Red Shield Insurance Company Vice President: Red Shield Service Company Red Shield Financing Company	Seattle, WA
Clayton R. Jones III	Director: Red Shield Insurance Company President and Director: Rainer Insurance Company Jones Stevedoring Company Treasurer, Secretary, and Director: Red Shield Service Company Red Shield Financing Company Secretary, and Director: Maritime Service Company Vice President and Director: Rothschild International Corporation	Mercer Island, WA
Frank J. Amato	Director and Officer: Red Shield Insurance Company Rainer Insurance Company Red Shield Service Company Maritime Service Company Director and Vice President: Jones Stevedoring Company	Kirkland, WA

Edward D. Fournier	Vice President and Director: Red Shield Insurance Company Red Shield Service Company	Bellevue, WA
John P. Visich	Treasurer and Director: Red Shield Insurance Company Assistant Treasurer: Red Shield Service Company Red Shield Financing Company	Bellevue, WA

Officers

Following were officers of the Company as of December 31, 2003:

<u>Name</u>	<u>Position</u>
Clayton R. Jones	President
Edward D. Fournier	Vice President
Frank Amato	Vice President, Secretary and Assistant Treasurer
John P. Visich	Treasurer and Assistant Secretary
William J. Groves	Assistant Secretary

Conflict of Interest

The Company has a policy statement and questionnaire for the disclosure of conflicts of interest and requires all directors, officers, and key employees to sign the statement annually. The signed statements are reviewed annually by the BOD for conflicts. No conflicts were noted in our review.

Fidelity Bond and Other Insurance

The Company is a named insured under a Financial Institution Bond written in the name of Rothschild International Corporation, which provides the following coverage:

<u>Type</u>	<u>Coverage Amount</u>	<u>Deductible</u>
Employee Dishonesty	\$1,000,000	\$25,000
Forgery or Alteration	\$1,000,000	\$25,000
Securities	\$1,000,000	\$25,000
Loss on the Premises	\$100,000	\$1,000
Loss in Transit	\$100,000	\$1,000
Depositors' Forgery	\$1,000,000	\$25,000

The fidelity coverage carried by the Company exceeds the minimum recommended amount by the NAIC.

Officers', Employees', and Agents' Welfare and Pension Plans

The Company has no pension plan for employees. Medical and dental benefits are offered to employees who meet certain requirements.

CORPORATE RECORDS

The Company's Board of Directors (BOD) managed the property and business of the Company and was actively involved in the Company's affairs. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes. Appointments and elections of officers, reinsurance contracts, bank agreements, and other contracts were also noted in the BOD's minutes.

LOSS EXPERIENCE

Introduction

The reserves carried by the Company for loss and loss adjusting expenses were \$6,409,402 and \$1,264,057, respectively, as of December 31, 2003. These reserves were reviewed by the OIC casualty actuarial staff.

Through its consulting actuarial firm, PricewaterhouseCoopers, the Company provided loss and loss adjustment expense development data by accident year and line of business. The OIC actuarial staff obtained additional information by interviewing several Company employees. The OIC actuarial staff also reviewed an actuarial report prepared by PricewaterhouseCoopers in support of the 2003 Statement of Actuarial Opinion.

The OIC actuarial staff's estimates indicate that the reserves for losses and loss adjustment expenses combined, on a net basis, are within a reasonable range of acceptable estimates. Therefore, these reserves are accepted as they appear in the Company's 2003 NAIC Annual Statement.

REINSURANCE

The Company reinsurance philosophy is to retain manageable portions of its direct writings and to ensure external coverage for business to maintain appropriate exposure in its portfolio. The following agreements are designed to cover all of the Company's lines of business capacity commensurate with that philosophy.

RSIC assumes and cedes reinsurance under quota share treaties with RIC, a related, unauthorized reinsurer in Washington State, whose direct premium in Washington and Oregon primarily consists of surplus lines of business. The Company retained \$5,505,000

in deposits as of December 31, 2003 to comply with RCW 48.12.160(1)(c)(i) for unauthorized reinsurers.

The Company assumes multi-line property and casualty risks from RIC under a quota share contract. In 2003, it assumed \$2,842,000 of net earned premiums and paid \$361,000 of commissions under this treaty.

RSIC cedes property damage/general liability, multi-line property and casualty and workers' compensation risks to RIC under several quota share treaties. In 2003, it ceded \$3,763,000 of net earned premiums and recognized \$2,009,000 of reinsurance commissions under these agreements.

The Company also cedes under other facultative obligatory, excess of loss reinsurance contracts with unaffiliated, authorized companies. The premiums ceded in 2003 were \$3,223,000.

STATUTORY DEPOSITS

The Company maintained the following deposits as of December 31, 2003 in compliance with statutory and special requirements:

<u>Location</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
California	Bank of America Certificate of Deposit	\$ 30,000	\$ 30,000	\$ 30,000
California	Bank of America Certificate of Deposit	70,000	70,000	70,000
Oregon	US Treasury Note 2.875%	400,000	400,154	403,624
Total		<u>\$ 500,000</u>	<u>\$ 500,154</u>	<u>\$ 503,624</u>

Special deposits which are held for the protection of the Policyholders:

<u>Location</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Washington	US Treasury Note 5.875%	\$2,000,000	\$1,991,641	\$2,011,880

Securities held by the state of Washington and other states were confirmed directly with the Company's authorized representatives.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a modified Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, disaster recovery plan.

SUBSEQUENT EVENTS

No material subsequent events were disclosed during the examination.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All prior examination report instructions were satisfactorily addressed and corrected.

FINANCIAL STATEMENTS

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RED SHIELD INSURANCE COMPANY
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2003

	BALANCE PER COMPANY	REF NOTE	EXAM ADJUSTMENT	BALANCE PER EXAM
Assets				
Bonds	\$ 20,263,378		\$ 0	\$ 20,263,378
Stocks:				
Preferred stocks	634,180			634,180
Common stocks	756,959			756,959
Mortgage Loans on real estate	555			555
Cash and short-term investments	15,574,534	1	(444,637)	15,129,897
Subtotal, cash and invested assets	37,229,606		(444,637)	36,784,969
Investment income due and accrued	143,215			143,215
Premiums and considerations				
Uncollected premiums and agents' balances in course of collection	545,915			545,915
Current federal and foreign income tax recoverable and interest thereon	162,293			162,293
Net deferred tax asset	327,680			327,680
Receivable from parent, subsidiaries and affiliates	35,351			35,351
Total Assets	\$ 38,444,060		\$ (444,637)	\$ 37,999,423
Liabilities, Surplus and other Funds				
Losses	\$ 6,409,402			\$ 6,409,402
Loss adjustment expenses	1,264,057			1,264,057
Other expenses	92,014			92,014
Taxes, licenses and fees (excluding federal and foreign income taxes)	701			701
Unearned premiums	3,609,051			3,609,051
Ceded reinsurance premiums payable	175,982			175,982
Funds held by company under reinsurance treaties	5,505,275			5,505,275
Total Liabilities	17,056,482		0	17,056,482
Common capital stock	1,625,000			1,625,000
Unassigned funds (surplus)	19,762,578	1	(444,637)	19,317,941
Surplus as regards policyholders	21,387,578		(444,637)	20,942,941
Total Liabilities, Surplus and other Funds	\$ 38,444,060		\$ (444,637)	\$ 37,999,423

RED SHIELD INSURANCE COMPANY
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2003

	<u>BALANCE PER COMPANY</u>	<u>REF NOTE</u>	<u>EXAM ADJUSTMENT</u>	<u>BALANCE PER EXAM</u>
STATEMENT OF INCOME				
Underwriting Income				
Premiums earned	<u>\$9,966,758</u>		<u>\$0</u>	<u>\$9,966,758</u>
Deductions				
Losses incurred	3,782,368			3,782,368
Loss expenses incurred	1,909,521			1,909,521
Other underwriting expenses incurred	4,101,728			4,101,728
Total underwriting deductions	<u>9,793,617</u>		<u>0</u>	<u>9,793,617</u>
Net underwriting gain or (loss)	173,141		0	173,141
Investment Income				
Net investment income earned	936,569		0	936,569
Net realized capital gains or (losses)	<u>163,842</u>		<u>0</u>	<u>163,842</u>
Net investment gain or (loss)	1,100,411		0	1,100,411
Net income, after dividends to policyholders but before fed. And foreign income taxes	1,273,552			1,273,552
Federal and foreign income taxes incurred	<u>452,707</u>		<u>0</u>	<u>452,707</u>
Net income	<u><u>\$820,845</u></u>		<u><u>\$0</u></u>	<u><u>\$820,845</u></u>
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	<u><u>\$20,315,462</u></u>			<u><u>\$20,315,462</u></u>
Gains and (Losses) in Surplus				
Net income	820,845			820,845
Change in net unrealized capital gain/losses	172,303			172,303
Change in net deferred income tax	(41,317)			(41,317)
Change in nonadmitted assets	(54,715)	1	\$ (444,637)	(499,352)
Change in provision for reinsurance	<u>175,000</u>			<u>175,000</u>
Change in surplus as regards policyholders	<u>1,072,116</u>		<u>(444,637)</u>	<u>627,479</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$21,387,578</u></u>		<u><u>\$ (444,637)</u></u>	<u><u>\$20,942,941</u></u>

RED SHIELD INSURANCE COMPANY
***RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE THE LAST**
EXAMINATION
FOR THE YEAR ENDED DECEMBER 31, 2003

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Capital and surplus, December 31, previous year	<u>\$ 20,315,462</u>	<u>\$ 23,703,182</u>	<u>\$ 20,289,971</u>	<u>\$ 19,062,780</u>	<u>\$ 18,425,611</u>
Net income	820,845	794,337	1,270,391	1,251,538	1,262,265
Net unrealized capital gains or (losses)	172,303	(157,778)	(49,950)	89,716	(293,938)
Change in net deferred income tax	(41,317)	145,550	144,551	0	0
Change in nonadmitted assets	(54,715)	5,171	(25,548)	(59,063)	(77,158)
Change in provision for reinsurance	175,000	(175,000)	0	0	0
Change in excess of statutory reserves over statement reserves	0	0	0	(55,000)	(254,000)
Cumulative effects of changes in accounting principles	0	0	2,073,767	0	0
Transfer from surplus (stock dividend)	0	0	0	0	325,000
Transfer to capital (stock dividend)	0	0	0	0	(325,000)
Dividends to stockholders	0	(4,000,000)	0	0	0
Change in surplus as regards policyholders for the year	<u>1,072,116</u>	<u>(3,387,720)</u>	<u>3,413,211</u>	<u>1,227,191</u>	<u>637,169</u>
Surplus as regards policyholders, December 31, current year	<u>\$ 21,387,578</u>	<u>\$ 20,315,462</u>	<u>\$ 23,703,182</u>	<u>\$ 20,289,971</u>	<u>\$ 19,062,780</u>

* = Compiled from Company filed NAIC Annual Statements

RED SHIELD INSURANCE COMPANY
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE
EXAMINATION
AS OF DECEMBER 31, 2003

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>EXAMINATION ADJUSTMENT REF NOTE</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>	<u>TOTAL</u>
Capital and Surplus, December 31, 2003 - Per NAIC Annual Statement					\$ 21,387,578
<u>ASSETS</u>					
Cash & Short Term investments.	15,574,534	15,129,897	1	(444,637)	

LIABILITIES

Change in surplus					<u>(444,637)</u>
Capital and Surplus, December 31, 2003 - Per Examination					<u><u>\$ 20,942,941</u></u>

NOTES TO THE FINANCIAL STATEMENTS

1) Investments

The Company's investments in Vanguard Mutual Funds exceed the maximum amount that is allowed by RCW 48.13.030(1), which states that a domestic insurance company shall not have investments in one entity in an amount exceeding more than 4% of its total assets unless the investment is backed by the full faith of the United States Government.

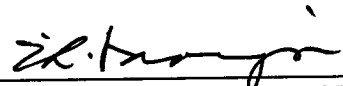
Therefore, an examination adjustment was made, reducing the admitted amount of the Company's investments in Vanguard Mutual Funds to 4% of the Company's total admitted assets or an adjustment of \$444,637. (See Instruction No. 3)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Red Shield Insurance Company during the course of this examination.

In addition to the undersigned, Mike Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Tarik Subbagh, CPA, MSBA, Insurance Examiner; John Gaynard, CPA, CFE, CPCU, Reinsurance Specialist; Timothy F. Hays, CPA, JD, Investment Specialist; CJ Mitchell, CPA, MBA, Insurance Examiner; Bert Karau, CPA, Insurance Examiner; Ann Kauffman, CPA, Insurance Examiner; Jeanette Liao, Insurance Examiner; Lee Barclay, FCAS, MAAA, Senior Actuary; Jim Antush, Actuarial Analyst; and John Jacobson, AFE, Automation Examination Specialist, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Timoteo L. Navaja, CFE, CIE
Examiner in Charge
State of Washington

AFFIDAVIT


**STATE OF WASHINGTON }
COUNTY OF KING }** ss

Timoteo L. Navaja, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Red Shield Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).


Timoteo L. Navaja, CFE, CIE
Examiner in Charge
State of Washington

Subscribed and sworn to before me this 12th day of May, 2005.


Notary Public in and for the
State of Washington.

